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No. 03-660

In the Supreme Court of the United States

JACK FREEMAN AND JANET FREEMAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether, under Section 61(a) of the Internal Revenue Code, 26 U.S.C. 61(a), respondents' gross income from the proceeds of litigation includes the portion of their damages recovery that is paid to their attorneys pursuant to a contingent fee agreement.

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OPINIONS BELOW

The memorandum opinion of the court of appeals (Pet. App. 2-3) is not published in the *Federal Reporter*, but it is reported at 56 Fed. Appx. 842. The opinion of the Tax Court (Pet. App. 4-25) is unofficially reported at 82 T.C.M. (CCH) 643.

JURISDICTION

The judgment of the court of appeals was filed on March 25, 2003. The petition for rehearing was denied on July 25, 2003. Pet. App. 1. The petition for certiorari was filed on October 23, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Jack Freeman brought suit against his employer for wrongful termination of his employment. He was awarded damages in the amount of $314,173 in

that suit. Under the contingent fee agreement that petitioner had made with his attorney, the attorney was authorized to, and did, retain $114,532 of the damages award. Pet. App. 5-10.

Petitioner filed a joint tax return with his wife. That return did not include any portion of the damages award in their gross income. The Internal Revenue Service determined that the entire amount of the damages award, including the portion retained by the attorney as a contingent fee, was to be included in petitioners' gross income. Because no deduction is allowed for attorneys fees in computing the alternative minimum tax (AMT) (see 26 U.S.C. 56(b)(1)(A)(i)), the Service determined an AMT liability against petitioners in the amount of $52,303. Pet. App. 5-11.

2. Petitioners sought review of the tax deficiency determination in the Tax Court. The Tax Court held that the entire amount of the damages award, including the portion retained by the attorney under the contingent fee agreement, was to be included in petitioners' gross income.[1] The Tax Court noted that the courts of appeals are in conflict in their resolution of that issue. The court pointed out, however, that the Ninth Circuit, to which an appeal would lie in this case, had firmly rejected petitioners' contention and ruled that the portion of a damages recovery paid under a contingent fee agreement to the taxpayer's attorney is included in the taxpayer's gross income. Pet. App. 19 (citing *Benci-*

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[1] In the Tax Court, petitioners claimed that a portion of the damages award represented a recovery on account of personal injuries that is excluded from tax under Section 104(a)(2) of the Code, 26 U.S.C. 104(a)(2). The courts below rejected that claim (Pet. App. 3, 14-16), and petitioners have not sought to raise that issue in this Court.

Woodward v. *Commissioner*, 219 F.3d 941 (9th Cir. 2000), cert. denied, 531 U.S. 1112 (2001)). The court therefore held that the Ninth Circuit rule was applicable to this case (Pet. App. 19-20):

> Petitioners acknowledge that the court to which an appeal of this case lies, the Court of Appeals for the Ninth Circuit, has rejected their position in *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000), affg. T.C. Memo. 1998-395. In that case, the court held that an award of punitive damages was fully includable in the taxpayers' gross income, notwithstanding the fact that a portion of the award was retained by the taxpayers' attorney, pursuant to a contingent fee agreement. *Id.* The Court of Appeals noted that under California law, the law applicable in that case and in the instant case, "an attorney lien does not confer any ownership interest upon attorneys or grant attorneys any right and power over the suits, judgments, or decrees of their clients." *Id.* at 943.

Because this issue had been decided adversely to petitioners by the Ninth Circuit in *Benci-Woodward*, and by the Tax Court itself in several other cases, the court concluded that "[w]e have no reason to reconsider the issue in this case." Pet. App. 21. The court therefore upheld the AMT liability asserted by the Commissioner. *Ibid.*

3. In a brief memorandum opinion, the court of appeals affirmed. Pet. App. 2-3. The court stated that "[t]he judgment of the United States Tax Court is affirmed for the reasons stated by Judge Whalen in his memorandum opinion dated September 28, 2001." *Id.* at 3.

DISCUSSION

This case presents the same question presented in the petition for a writ of certiorari filed by the government in *Commissioner* v. *Banks*, No. 03-892 (filed Dec. 19, 2003).[2] In *Banks*, the Sixth Circuit issued a comprehensive opinion that purports to establish a rule that governs the taxation of the portion of a damages awards paid as contingent fees under the laws of any State. In the present case, by contrast, the court of appeals issued only a brief, memorandum opinion that purports to resolve this question only for the portion of damages awards paid as contingent fees under the laws of California. See Pet. App. 3 (adopting Tax Court decision); *id.* at 19 (Tax Court decision that adopts Ninth Circuit rule for contingent fee agreements made "under California law"). Because the decision in *Banks* contains a full discussion of the alternative grounds for disposing of the question presented as it arises under contingent fee agreements made in every State, that case presents a more appropriate vehicle for resolving the important, recurring question on which the courts of appeals throughout the Nation have divided. See 03-892 Pet. at 7-8. It would therefore be appropriate for this Court to grant the petition for certiorari in *Banks* and to hold the petition in the present case for disposition in light of the disposition of the petition in *Banks*.

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[2] A copy of the government's petition for a writ of certiorari in *Commissioner* v. *Banks*, No. 03-892, is provided herewith to petitioner.

CONCLUSION

The petition for a writ of certiorari in this case should be held and disposed of as appropriate in light of the disposition by this Court of the petition for a writ of certiorari in *Commissioner* v. *Banks*, No. 03-892.

Respectfully submitted.

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